The Free Market

"If you don't create a free market, a black market will emerge"

NEWSLETTER OF THE LITHUANIAN FREE MARKET INSTITUTE - www.freema.org/Newsletter/index.phtml

CONTENTS:

ANNIVERSARY

LFMI celebrated its fifteenth birthday anniversary

On October 13, 2005, the Lithuanian Free Market Institute (LFMI) held a ceremony to celebrate its fifteenth anniversary. More than one hundred of LFMI's supporters, fellows, foreign partners, prominent politicians, and media representatives participated in the anniversary event to manifest their support for the mission pursued by the only free-market oriented think-tank in Lithuania and one of the oldest right-wing NGOs in Europe. LFMI was also the first centre established in Lithuania after restoring its independence that started to provide independent economic analysis.

LFMI was deeply honoured to host **Dr. José Piñera**, the architect of the Chilean pension reform – "the pension world's equivalent of Placido Domingo" as the London Sunday Telegraph wrote - as the distinguished guest speaker of LFMI's anniversary event. During the dinner, Mr. Piñera spoke on the topic "Effective solidarity versus proclaimed solidarity in the fight against poverty and injustice". In his speech Dr. Piñera wished the Lithuanian Free Market Institute great success and explained what role he envisages for LFMI in the near future: "In the first fifteen years, you have helped create an independent and free country - my deepest respect for that. You have helped Lithuania become a part of Europe-- also my deepest respect for that. But now you have another extraordinary challenge - how to make Lithuania join the Euro area without the labour rigidities and the Bismarckian welfare state that are burdening Western European countries. I believe you will rise to the challenge and will be at the front in this cause. Remember the three principles: love of country as the force, the power of ideas as the compass, and life, liberty and the pursuit of happiness as the noble goals."

LFMI's President Ugnius Trumpa and Dr. José Piñera

Among the guests was Adviser to President of Lithuania Dr. Ramunas Vilpisauskas who read the **President's greetings to LFMI**. In his official letter President Valdas Adamkus stressed that LFMI team's weighty and constructive contribution to essential reforms and public debates has been visible from the very start of the Institute's activity: "You have always managed to find a healthy balance between a critical approach towards all administrations who based their policies on entirely different ideologies, and a constant dialog with government institutions." President Adamkus also said in his letter to LFMI: "I can unequivocally state that the Lithuanian Free Market Institute has already made a conspicuous trace in the history of Lithuania who regained its independence only fifteen years ago. […] I believe the Lithuanian Free Market Institute will remain one of the leading participants in the debates over economic realities in Lithuania and beyond its boundaries. I believe that your critical and rational voice will continue to be heard in the future well."

A welcoming letter also came from Vilnius' city Mayor Arturas Zuokas who pointed that people from the Lithuanian Free Market Institute taught Lithuanian people to think and act freely from the first years of the country's independent life. "Remain as free from short-term political conjuncture and pressure as until now. Only free people can protect the free market," – Vilnius Mayor signed.

Adviser to President of Lithuania Dr. Ramunas Vilpisauskas and LFMI's President Ugnius Trumpa

To mark the fifteenth anniversary, LFMI released a **book "Laisves algoritmai" ("Algorithms of Liberty")** presenting a collection of the most valuable articles by LFMI written during the fifteen years of its activity. The publication of almost 400 pages not only reflects LFMI's work since its foundation but also mirrors the most significant events and processes in Lithuania's economic, social and political life after its independence was restored.

As famous Lithuanian philosopher Prof. Dr. Leonidas Donskis wrote in his review, "LFMI's book "Laisves algoritmai" illustrates remarkably the principles, the spirit and the ambition of this institution. This collection has an indubitable analytical as well as historical value: its authors' insights and critique of the government action and trends in the country's life allows us tracing and analysing Lithuania's transformation during the fifteen years of its independence." (*In the photo above: LFMI's President Ugnius Trumpa presents the book "Laisves algoritmai" to the guests of LFMI's ceremony*).

The Lithuanian Free Market Institute (LFMI) is an independent non-profit organization established in 1990 to promote the ideas of individual freedom and responsibility, free market and limited government. In the fifteen years of existence LFMI has addressed a variety of core issues confronting the economic reform process, enriching public debates, making a profound impact on the legislative outcome, and strengthening the democratic process. LFMI promoted the idea of a currency board and provided decisive input to the Law on Litas Credibility. LFMI led the creation of the legal and institutional framework for the securities market and contributed significantly to the privatisation legislation. LFMI initiated and participated in the policy-making process on private pension insurance through pension funds. LFMI's recommendations have adopted in legislation on commercial banks, the Bank of Lithuania, credit unions, insurance, and foreign investment. LFMI have influenced significantly the improvement of company, bankruptcy and competition law.

(from the left) LFMI's President Ugnius Trumpa, Secretary of the Ministry of Social Affairs and Labour Audrone Morkuniene, Advisor to Vilnius Mayor, LFMI's Associated Policy Analyst Ruta Vainiene and Secretary General of F. A. v. Hayek Institut in Vienna Dr. Barbara Kolm-Lamprechterr. A.Morkuniene and R.Vainiene both come from the LFMI team.

LFMI have developed a conceptual proposal for tax and budget reform. Proposals from LFMI have been adopted in policy debates on income taxation, real estate tax, inheritance and gift taxes, and others. In recent years LFMI has been closely working on business deregulation, a process, initiated by the institute, worked actively in creating the legal framework for telecommunications market, formulated and proposed a step-by-step plan for health care reform, and took an active part in the debates over Lithuania's accession to the European Union.

Director of Institute Relations, Atlas Economic Research Foundation, Dr. Jo Kwong and General Manager of "Reval Hotel Lietuva" Juha Mahonen

Executive Director of Institute for Market Economics in Bulgaria Krassen Stanchev (left) and Senior Fellow from Atlas Economic Research Foundation Gabriel Sanchez-Zinny (right)

(from the left) LFMI's Vice President Guoda Steponavičienė, Director of Logistics Dpt. of one of the leading holdings "Achemos grupė" Otonas Tikuišis and Research Director of Institut Constant de Rebecque in Switzerland Dr. Alphonse Crespo

(from the left) LFMI's Vice President Dr. Remigijus Simasius and Member of Parliament Raimundas Palaitis

More pictures can be found at: http://www.freema.org/Events/Annual05.phtml.

EUROPEAN RESOURCE BANK MEETING

The European Welfare State: the Road to Nowhere

On October 14-15, 2005 the 2nd European Resource Bank Meeting (ERBM) entitled "The European Third Way: the Way Forward?" was held in Vilnius, the capital of Lithuania. It was hosted by the Lithuanian Free Market Institute (LFMI), one of the oldest and most active free-market think tanks in Europe celebrating its 15th anniversary in the autumn of 2005. The event drew prominent free-market economists from Europe, Chile, and the USA to debate the future of the crumbling European social model. Around one hundred participants from 24 countries took part in the 2nd ERBM. The idea to organize annual gatherings in Europe has been borrowed from the USA's greatest NGOs - the Heritage Foundation and the ALTAS Economic Research Foundation who have been staging similar forums for decades. These events bring together around four hundred promoters of liberty every year to discuss and work out a better case for the free market course.

Vision: Only Voluntary Private Pension Insurance

LFMI was honoured to host the world's distinguished economist, the architect of Chile's pension reform **Dr. José Piñera**, visiting Lithuania for the first time, as ERBM's key speaker. Twenty-five years ago, Dr. Piñera developed and implemented successfully a fundamental and then radical pension reform by introducing a fully funded pension system which replaced the state-run pay-as-you-go (paygo) system. He was also invited by a number of country leaders to explain to them "the Chilean miracle," among them being Presidents of the United States Bill Clinton and George W. Bush, Russia's President Vladimir Putin and Italia's Prime Minister Romano Prodi.

Delivering his speech "Towards the World of Worker-Capitalists," Dr. Jose Piñera did not provide statistics and other specific issues, but spoke about his aspiration to see the Chilean people not slaves to the state-run social security system, but as economically free citizens (capitalists); he told the ERBM audience about his personal choice between a comfortable professor's chair in the USA and coming back to his native country Chile plagued by a crisis, about the power of ideas and other similar notions that are equally important as the pension reform in Lithuania and other European countries. (Dr. Piñera's revised speech is presented in this issue of "The Free Market").

According to Piñera's pension system model, the entire contribution paid to the mandatory state-run pension insurance fund had to be transferred to the worker's individual retirement savings account held in a chosen private pension fund and became his or her property. This pension reform stands out as highly consistent: the state-run paygo system has been dismantled fully and at one time, which hasn't been repeated in any other country of the world. Later countries chose a model propagated by the World Bank – a three-pillar pension system in which the paygo system is maintained intentionally. Lithuania is also among the countries who have launched a pension reform in a "cautious" way, by allowing to transfer to private pension funds only 2.5 percentage points of the social security contribution until it reaches 5.5 percentage points in 2007. the ERBM participants agreed that the paygo systems are very sensitive to demographic changes and political speculations and undermine workers' incentives. However, in practice the battle is being won by political arguments such as the state's duty to take care of the pensioners, that is why the current paygo systems, labelled as the "Titanic" and "crashing planes," fail to undergo such sweeping changes as the one in Chile.

Participants of the 2nd ERBM also debated what could supplant the decaying pyramid of social security and what alternatives exist for the European pensioners. **Dr**. **Ján Oravec,** the Slovakian reform architect and Adviser to Prime Minister, highlighted, while shaping the future tendencies in pensions, that Piñera's model was but the first step towards an effective pension system, befitting a free society, as it preserves an element of coercion: both Chileans and citizens of other countries that have introduced the second pillar in the pension system based on private saving *must* save for the old age nonetheless. There is no doubt that this was a gigantic step forward, as compared to the paygo system where contributions must be paid to one state-run fund, being redistributed rather that invested, and where the payer is not an owner of these contributions. However, the element of coercion should vanish in the future, and the state should no longer force its citizens to save for their pensions in one or the other pinpointed way. As a result, the pension system is to boil down to what we call the third pillar today – the voluntary private pension insurance or saving only. According to Mr. Oravec, such goals are awaiting us in the coming decades. On the other hand, ERBM participants raised a major question if decades would not be too late. In other words, decades might be too lengthy a period of time because the unreformed state pension systems might eventually collapse and hit the countries' economies so severely that politicians will see more crucial tasks to handle at that moment than the wellbeing of pensioners.

Waldemar Inghal, Director of the Eudoxa, Sweden, touched upon one more noteworthy issue, and that is the altering concept of living in the old age. If a pension-age individual is not entirely dependent on the state-provided pension, state funding of health care and state-rendered education, he will prove to be an economically active individual. There is much likelihood that under such circumstances individuals would be able to use life-learning opportunities, to improve their qualification and take better care of their health, as compared to the current pensioners. Also, it is probable that such people, at their retirement age, would be capable of, and tend to, set up their own businesses. Consequently, they will possess a certain amount of income from labour (or real estate) apart from their state-paid pension. Mr. Inghal concluded that if people perceive ageing as dynamic they will see the benefits of private insurances, and career reinvention. People dare to seize opportunities if they see openings, and total safety will not be necessary.

The ERBM discussions also revolved around the specific issues of practical policy which ensue when conducting the so-called parametric, or incomplete, reforms of pension systems. **David Lipka** from Liberalny Institute in the Czech Republic stated that the essential economic problem to be solved while reducing the scope of the paygo system is a deficit emerging when a share of the social security contribution is redirected to private pension funds. In his opinion, it is fair both from the economic and social point of view to cover this shortage by proceeds from privatization. LFMI proposed and advocated an identical recommendation when the pension reform was being contemplated in Lithuania several years ago.

How to Shift from State Funding of the Health Care?

At the European gathering, promoters of the free-market thought also addressed the issues of the health care reforms in Europe and asked a question who will pay for every European's "right" to covered health care. On the one hand, every free marketer and every economist find it obvious that the thing called "the right to health" doesn't exist (just as the right to have a job, rest, and the internet and all other positive rights) because there is no agency who would have a duty and realistic abilities to ensure these rights. Equally the same it is evident that health care services, just as any other type of services, have to be covered by an individual himself. In her presentation **Dr. Guoda Steponavičienė,** LFMI's Vice President, named the core reasons why the health system financed from public sources cannot be sound and effective neither from the economic nor social nor medical point of view.

This conference focused on ways and methods of how to forego public funding of health care systems in Europe. ERBM participants discussed how to shift from a system in which the health care of a number of consumers is covered by others. As a result some people believe they have the right to get health care services for free, while others feel they are paying into a holey sack. After it was stated that, in the long run, people should have to pay for routine health care services from their own pockets and should insure privately to cover the expenses of serious (insured) illnesses, the questions were raised as to how, under market conditions, should be supported those people who are not insured by private companies due to a high risk of morbidity. **Dr. Alphonse L. Crespo**, an orthopaedic surgeon and Director of Research of the Institut Constant de Rebeque, Switzerland, conveyed an idea that there are numbers of forms of genuine – voluntary - solidarity existing in society, therefore if taxes and mandatory health insurance contributions were reduced, a more favourable environment would emerge for philanthropic activities of individuals, corporations, patient organisations and communities. Once the state usurps the role of providing care to the poor and the sick, people direct their voluntary support to other, often secondary, areas. The discussion rounded up in a conclusion that the choice of funding in health care will eventually depend for the most part on whether society understands the damage being done by "free treatment" and its willingness to take responsibility for one's health.

Educations systems crave for competition

Apart from the European pension and health care systems, the 2nd ERBM addressed the funding of education systems, the issue that has been causing serious concern in Europe in the recent years. **Prof. Nils Karlson**, President and CEO of the Ratio Institute, Sweden, explained the highly appraised voucher reform in the secondary education system in Sweden which was conducted more than a decade ago and implemented the principle "money follow students." Lithuania has carried out a similar reform in its secondary education system, however, the Swedish reform is seen as a more consistent one because under the Lithuanian model the voucher money in the end is redistributed from successful schools to underperforming ones anyway. Prof. Karlson pointed that the secondary education reform in Sweden has lead education establishments to focus on their clients –even being financed by the state, students gained more opportunities to control the quality of services provided. New types of private schools emerged, the remainder was forced to improve, and no negative effects have been observed after the Swedish reform. Even when the opponents of the reform - the Swedish social democratic party - won the election, this successful step was not overthrown. The major reason was that the party's leaders started to send their offspring to the new private schools.

Alberto Mingardi, General Director of the Insituto Bruno Leoni, also stressed the importance of education in society, underlying that education should be organized according to people's choice rather the government's plan. This is the only way to achieve that the government propaganda was not being foisted on society members from their early days. He highlighted that the liberal people, who are deeply concerned with the state-run education today, are in part to be blamed themselves for such a state of affairs. Being enthusiasts of education, they strongly backed the idea of introducing public compulsory education which has lead directly to the mindset that the provision of education services should be a state function. The ERBM debate was prevailed by views that the amount of education is not a primary concern and that people should be able to receive as much of education as they need, whereas the existing funding and organization of the education system stimulate its artificial expansion. This results in poor quality, expensive education services, and subtly censored contents of education in European countries.

Free-market think tanks are not in consensus on some educational reforms. Some believe that the implementation of voucher reforms in the secondary and higher education systems would create preconditions for competition and bring improvement thereof. Others think that such reforms are in principle the salvation of the defective system and spoiling of private initiatives as market participants would tend to correspond to the state-regulated needs rather than the free choices of their customers. But the idea predominated that the current education system is too costly and does not conform to people's needs.

The Illusion of "The Third Way"

Although the impressions and conclusions of ERBM participants differed quite considerably, they agreed unanimously that there isn't and can't be any third way in the economy. The formation called "the third way" is just a mixture of the two systems – the market economy and the central planning, and its composition rests on time, local topicalities, fashions and tastes. With an exception of perhaps only Dr. Jose Piñera, most of the speakers focused their presentations less on the criticism of the welfare state but more on discussing various schemes of market reforms (such as advantages and shortcoming of the voucher reforms, further stages of the pension reform, etc.), reform tactics and opportunities of think tanks in this endeavour.

The panel on economic security demystified the fallacious myths regarding the state's role. If somebody nursed hopes that the state is its citizens' best saviour from domestic violence and foreign aggression, this idea had to be berried after listening to **Prof. Hans Hermann Hoppe's** speech on the real dangers to economic security (the transcript of his speech of presented in this issue of "The Free Market"). In his speech on financial institutions, their regulation and the impact on security and terrorism, **Dr. Richard W. Rahn,** Director General of the Center for Global Economic Growth, explained the effects that are contrary to those sought by extensive and meticulous regulation of the financial sector. He concluded that if financial institutions and their customers are weakened or bled to death by regulatory malpractice, the war against real criminals and terrorists will be made more difficult (the paper is presented in this publication). **Dr. Remigijus Šimašius**, LFMI's Vice president, delivered a presentation on the real and imagines dangers of economic security on the Baltic Region. He highlighted that if economic security is understood as the absence of uncertainty whatsoever this will never be attained as it is simply impossible. Measures aimed at ensuring security are a big burden on national budgets, i.e. the taxpayers. Moreover, governments' efforts to increase security invariably impose extra costs and may be the cause for insecurity instead. Dr. Šimašius suggested that it is openness and markets rather than boundaries and planning is the proper way to increase economic security.

Debates in the workshops on the 2nd day was a real testimony that free-market think tanks in the USA are far more active and influential that their European counterparts. Moreover, the American society has a more favourable attitude, as compared to the Europeans, towards the mission and activities of NGOs (they at least don't need to keep making out that NGOs and lobbyists are two different things). The activities of the European think tanks are also being impaired by the fact that the societies in their countries are concerned mostly about the domestic issues only, while an increasing number of decisions is being made at the EU level. It is extremely difficult, if not impossible, for individual think tanks to reach the airs of EU institutions so the issue of how to act in Europe as a united movement remains among the most pressing tasks.

ERBM participants repeated various arguments that even though the model of the welfare state seems attractive it is doomed to ineffectiveness and, under the conditions of globalization, even to the downfall. This forces the pro-market economists to search for alternative solutions. The free market is a lighthouse showing the course in this search, however, tremendous work is in store for free-market think tanks showing to society the inevitable collapse of the current pension, health care and education systems, ways leading to the free market and specific measures that would help to get move from the current deadlock. It is natural to believe that think tanks don't lack ideas. What they lack most is managing to speak in the way that the listeners would be willing to hear what they say.

Pictures from the 2nd ERBM can be found at: **http://www.freema.org/ERBM/**.

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NEWS

LFMI: the Lithuanian Government should call EU member states for reconsidering the excise duty policy

Continuing its project on the excise tax policy, the Lithuanian Free Market Institute (LFMI) disseminated an address to Lithuanian MPs, followed by a press release, October 20, 2005, stating that the Lithuanian Government should take all possible measures to protect national interests and to call EU institutions and other member states for launching an overhaul of EU's excise tax policy. LFMI pointed out that it is Lithuania and the EU who set the level of excise duties, so it is in their power to alleviate the burden of proliferating oil prices for people and companies. LFMI urged the Lithuanian Parliament to adopt a resolution put forth by the opposition which invited the Lithuanian Government to appeal to the European Commission with specific recommendations on how to reduce the skyrocketing oil prices and their effects. However, the Parliament voted "no" to this resolution.

LFMI proceeded this initiative and staged a press conference, October 27, to urge the Lithuanian Government not to berry the idea of promoting lower excise duties and presented a comprehensive list of arguments to be employed in seeking for a revision of the excise tax policy in the EU. It should be noted that LFMI propagates a reduction of the minimal level of excise duties set by the EU for all excise goods – fuel, tobacco products and alcohol.

LFMI proposes changing the sources of financing roads

On September 13, 2005 LFMI held a press conference to present a study on prospects for, and alternatives of, funding road maintenance in Lithuania. The study is aimed at analysing what sources, excluding an increase of the general tax rates, could be used to finance roads and what influence they would exert on the behaviour of market participants.

LFMI's policy analysts recommend the Government to draw a long-term strategy for funding road maintenance and to follow it strictly in shaping the country's tax policy. In the study, LFMI analysed the advantages and shortcomings of all current and potential sources of financing roads and concluded that a tax collected from users of roads would be the most justified source of funding from the economic point of view. In the future, direct taxation of users of roads should become the only source for funding road maintenance in Lithuania, and other taxes that are currently allocated to finance roads should be reduced.

"The Wall Street Journal" features R. Vainienė's dictionary of economic terms

"The Wall Street Journal" published an article "Defining Capitalism Up" about a "Dictionary of Economic Terms" by Ruta Vainienė, LFMI's associate policy analyst, highlighting that a group of young free-marketeers in Central and Eastern Europe are initiating the fight against the poisoned economic vocabulary inherited from their communist past.

The WSJ starts its article by George Orwell's famous statement made in 1946 that his native language "becomes ugly and inaccurate because our thoughts are foolish, but the slovenliness of our language makes it easier for us to have foolish thoughts." The author of the article noted that today a group of young free-marketeers in Central and Eastern Europe have discovered the same thing - discussions of economics in their countries are being poisoned by a vocabulary inherited from their communist past.

The WSJ writes that Ruta Vainienė, a young former central banker in Lithuania, has decided to do something about it. Last month, she published her plainly titled "Dictionary of Economics." The response, both in Lithuania and elsewhere in Europe, has been striking. Since its release, the Dictionary has been the No. 2 nonfiction best seller in her native country. And plans are now afoot to translate the book into local-language editions in a number of other countries. Think tanks around Europe are supporting the effort, having seen the necessity of cleaning up economic language and thought that, a decade and a half after the collapse of the Soviet empire, remains infected by history…

The entire article is posted online: http://www.opinionjournal.com/taste/?id=110007466.

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ERBM SPEECH

The following is a revised version of the speech delivered by José Piñera at the 2nd European Resource Bank Meeting, Vilnius, October 14, 2005. José Piñera is Founder and President of the International Center for Pension Reform (www.pensionreform.org) and Senior Distinguished Fellow of the Cato Institute (www.cato.org).

Toward a World of Worker-Capitalists

A revised speech of Dr. José Piñera, delivered at the 2nd ERBM, Vilnius, October 14

I would like to thank the Lithuanian Free Market Institute for inviting me to Vilnius to address this meeting of the European Resource Bank. I strongly believe in the power of ideas, and I strongly recommend that people who share similar ideas about freedom should network and exchange experiences, because our goal should not be just to write books and make speeches, but to make a difference, to create a better world for everyone.

Let me state my two basic convictions on this issue in a very clear way. First, the pay-as-you-go (paygo), unfunded, pension system that is prevalent in Europe, America and most of the world, is going bankrupt. It is like the "Titanic" going directly toward the iceberg of demographics. And, regrettably, most European leaders - presidents, ministers, and politicians - are like the captain of the "Titanic," dancing on the deck, but not telling the passengers the truth, nor changing the course of the "Titanic". Second, parametric pension reforms like increasing the retirement age, payroll taxes, etc., may slow the speed of the "Titanic" going towards the iceberg but do not solve the basic problems of a system that is structurally wrong and flawed.

The good news is that the worldwide pension crisis has created a great opportunity to empower workers through public policy while at the same time advancing liberty.

Since in almost every country workers are already compelled to contribute a substantial proportion of their wages to paygo retirement systems, the transformation of those systems into ones in which wealth is accumulated in personal retirement accounts can bring about a new paradigm, a world of worker-capitalists.

I believe that the world would be a better place if every worker were also an owner of capital. Workers would benefit from the appreciation of assets in the long term and feel more connected to the overall performance of the economy. The interests of the workers would be more in line with the interests of those who manage and control those assets, there would be less disparities of wealth, and workers would place a higher value on strong property rights and the rule of law. Above all, workers would find a new dimension of freedom and dignity in their lives.

This was my guiding vision 25 years ago when, as Minister of Labor and Social Security of Chile, I had the responsibility of designing and implementing a then radical pension reform. Chile's pension reform fully replaced the state-run paygo system with one of retirement savings accounts that are owned individually and managed by the private sector, and it has been a huge success.

It is important to note that pension reform in Chile was introduced as part of a coherent set of radical free-market reforms, with the understanding that implementing such changes simultaneously was the best way to increase economic growth and get the most out of each reform. As a result, the growth rate of the Chilean economy doubled from its historical level to around 7 percent a year for more than a decade. The average real rates of return on retirement accounts has averaged more than 10 percent since their inception in May 1981, and pension assets under management have grown to be around 80 percent of GDP.

However, the impact of pension reform in Chile has gone beyond impressive economic indicators. It has led also to a radical redistribution of power from the state to civil society and, by converting workers into individual owners of the country's capital, has created a political and cultural atmosphere more consistent with free markets, democracy and a free society.

It should be added that in Chile the same rationale of the 1980 pension reform has been extended, although imperfectly, to the areas of health and unemployment, with individual insurance (health) or accounts (unemployment) managed by the private sector.

In the 1990s, nine other Latin American countries followed the path opened by Chile, and today some 60 million Latin American workers own financial wealth in their retirement savings accounts. In the late 1990s and in this decade several countries of Central and Eastern Europe joined the reforming club, and now around 20 million workers have individual retirement accounts in that area. Moreover, in January 2001, Sweden, once a model welfare state, allowed its workers to put 2.5 percentage points worth of their 18.5 percentage payroll tax contribution into an individual account.

It should be emphasized that the Chilean pension model is a comprehensive alternative to the social collectivism initiated by German chancellor Otto von Bismarck at the end of the 19th century, which was the model for the welfare states of the 20th century.

By cutting the link between individual contributions and benefits —that is, between effort and reward— and by entrusting governments not only with the responsibility but also with the management of these complex programs, the Bismarckian paygo pension system turned out to be the central pillar of the welfare state, in which the possibility of winning elections by buying votes with other people's money —even with the money of other generations— led to an inflation of social entitlements, and thus to gigantic unfunded, and hidden, state liabilities.

Global demographic megatrends, such as longer life expectancy and reduced fertility rates, will accelerate the crisis of paygo pension systems, especially in mature developed economies such as those of Europe, the United States, and Japan. As former U.S. secretary of commerce Pete Peterson has observed: "*The costs of global aging will be far beyond the means of even the world's wealthiest nations —unless retirement benefit systems are radically reformed. Failure to do so, to prepare early and boldly enough, will spark economic crises that will dwarf the recent meltdowns in Asia and Russia. For this and other reasons, global aging will become not just the transcendent economic issue of the 21st century, but the transcendent political issue as well.*"

The Coming Crisis in Western Europe

In stark contrast to some of their neighbors to the east and in Latin America, the political elites in western continental Europe have so far been unwilling to engage in structural pension reform. For Europeans, that political paralysis will be disastrous if it continues, since the region's looming pension crisis is perhaps the most severe in the developed world. It is even possible that the pension time bomb may sink the euro in the long term.

The population in Europe is aging and declining. A trend that could have been perfectly manageable with foresight could turn into a catastrophe given the increasing unfunded liabilities arising from paygo public pension programs, now more than 200 percent of GDP in France and Italy, and more than 150 percent of GDP in Germany. This situation is especially difficult in a continent where entitlements are deeply entrenched in a welfare state culture.

The European Commission recently stated, "*There is a risk of unsustainable public finances in some half of EU countries. Belgium, Germany, Greece, Spain, France, Italy, Austria and Portugal are on this black list*." Furthermore, the monetary affairs commissioner of the European Union warned, "*There is only a limited window of opportunity for countries to get their public finances in order before the budgetary impact of aging takes hold as of 2010*" (EUobserver.com, May 21, 2003).

Some European countries have begun to recognize the fiscal consequences of these demographic imbalances. But regrettably they seem to believe that changing some key parameters of the PAYGO pension system will solve the crisis. In June 2003, France's Prime Minister Raffarin eloquently spoke to his country's National Assembly of the need for “lucidité demographique” and managed to eliminate some blatant privileges of the public workers pension system. These measures partially correct the abuses of the system but not its flawed roots. The recent German pension reform, basically tax credits for supplementary savings, were a failure because too many people simply cannot save extra money after paying huge payroll taxes. Italy, the country with the lowest fertility rate in the world, has annual public pension outlays of around 14.5 percent of GDP. Italians, who already face 33 percent payroll taxes for pensions, would need to increase those taxes to 48 percent to pay the benefits promised to the elderly.

Even though European leaders seem to believe that so-called parametric pension reforms will be sufficient to solve the crisis, there are three main reasons that conspire against that goal. First, the political viability of some of these reforms among members of the European Monetary Union is clearly asymmetrical. For example, it may be possible to raise substantially the legal retirement age across the board in a corporatist country like Germany once consensus is reached at the top. But in France, where the recent attempt at marginal adjustments in this area for government employees led not only to long and crippling strikes but even to the support of a majority of the population, that may prove impossible.

Second, it is probable that the most decisive “parametric” change—postponing the age that makes a worker eligible for full state pension benefits—will have unintended consequences. For example, it may induce changes in the behavior of those workers asked to extend their working lives. In countries with extensive welfare programs and lax disabilities procedures, that would simply mean shifting the source of state expenditure to another program or ministry. It must be kept in mind that the rigid European labor laws not only keep the unemployment rate high overall, but also make it especially difficult for older people to retain their jobs, or get new ones, since wages cannot adjust downwards to keep pace with declining old age productivity.

Finally, measures like postponing the retirement age, reducing benefits, or increasing payroll taxes entail a decrease in the already minimal “rate of return” for these contributions, thus leading eventually to a young worker revolt, through voice (strikes, etc.) or exit (leaving the system or even the country). Those measures mean an increase in the existing “rate of return gap”, making paygo systems even less favorable when compared to private savings alternatives.

Funded versus Unfunded Europe

So, a division is emerging between what can be termed a "Funded Europe" and an "Unfunded Europe." The first group comprises countries with large private pension systems (Britain and The Netherlands), those that have recently introduced personal retirement accounts and could go even further (Sweden and Poland), and those with such sound public finances that are able to “fund” the paygo system with general tax revenues (Ireland and Luxembourg). The second group comprises the four big countries that concentrate the bulk of EMU population and GDP— France, Germany, Italy, and Spain—and all the rest with unfunded paygo systems.

“Unfunded Europe” leaders may want to follow the old Latin American recipe—namely, devaluation, so that the ensuing inflation reduces the purchasing power of benefits. But “Funded Europe” will probably oppose devaluing the euro. A clash may ensue amidst the centers of decision making in Europe, especially within the board of the European Central Bank. Of course, this perspective may be behind the reluctance of increasingly “funded” countries like Britain, Denmark, and Sweden to join the eurozone.

More than renewed armed conflicts among European countries, as Martin Feldstein has envisioned, I believe that the prospects are for intense, exacerbated, maybe even violent, age wars. The young resenting the confiscation of a substantial part of their hard-earned salaries; the old living in permanent fear of the growing budget deficits and the possibility of substantial benefits cuts, either directly or through inflation.

It cannot be denied that European workers in the paygo pension system are like passengers on the Titanic. By destroying the essential link between effort and reward, between contributions and benefits, this collectivist system encourages what Bastiat called “legal plunder.” And by making the finances of the system dependent on fertility rates and life expectancies, it has been relegated to the wrong side of the European demographic megatrend of the 21st century toward aging and declining populations.

Some people think that massive immigration into Europe could postpone or even solve the problem. That is not so for several reasons. First, an economic one. Massive immigration of low paid workers would exacerbate the unemployment problems and reduce wages, diminishing the possible tax collections from payroll taxes. Second, the reckoning problem. Those workers will pay more taxes during their working lives, but they will live to collect benefits, so it is a postponement of the pension time bomb. Third, since the great wage differentials are with North Africa, it is impossible to disregard the problems of assimilation and religious tensions between largely Islamic immigrants and the rest.

European Integration versus the Bismarckian Welfare State

The way out is to introduce personal retirement accounts that re-establish that essential link between effort and reward and move toward defined-contributions rather than defined-benefits pension systems. Already 20 countries have followed this path, including important European ones like Poland and Sweden.

A system of personal retirement accounts would also improve labor mobility, another key to a well functioning monetary union. And, if complemented with a reform of the disability system, it would enlarge the available labor force and reduce wasteful government spending.

The prospects of the euro, and of European integration, would be much better if one of the big countries of the eurozone were to begin a transformation in this direction, leading the way for the rest to follow. Ultimately, if Europeans, Americans, or Japanese do not want to have enough babies, they will have to accumulate enough euros, dollars, or yen in personal retirement accounts.

Whatever the merits of its introduction, the euro is already a fact and its demise could weaken the noble and visionary effort of a common economic space in Europe that has brought prosperity and ensured peace.

If Europeans want to keep their common currency, they will have to abandon the Bismarckian pension paradigm and, while keeping a government-financed safety net, begin moving toward a comprehensive retirement system based on ownership, individual freedom, and self-reliance.

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ERBM SPEECH

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Theoretical Considerations on the Production of Security

A transcript of Dr. Hans Hermann Hoppe's speech delivered at the 2nd ERBM, Vilnius, October 15

Two of the most widely accepted propositions among political economists and philosophers follow:

First, the production of security, of law and order, must be undertaken by and is the primary function of government. Here, security is understood in the wide sense adopted in the American Declaration of Independence, as the protection of life and property from domestic violence as well as foreign aggression. In accordance with generally accepted terminology, government is defined as a territorial monopoly of law and order, and as such is the ultimate decision maker and ultimate enforcer in cases of conflict.

Secondly, every monopoly is bad from the consumers' point of view. Monopoly here is understood in its classical sense as an exclusive privilege granted to a single producer of a commodity or service, i.e. as the absence of free entry into a particular line of production. In other words, only one agency, A, may produce a given good, x. Any such monopoly is bad for consumers because shielded from potential new entrants into the monopolist's area of production, the price of its product x will be higher and the quality of x lower than otherwise.

That both propositions are clearly incompatible has rarely caused concern among economists and philosophers. In so far as it has, the typical reaction has been one of taking exception to the second proposition rather than the first.

Indeed the first proposition - that law and order must be provided by a state - has become a dogma and a taboo subject.

Nonetheless, there exist strong, indisputable arguments as well as abundant empirical-historical evidence that it is the first proposition which is false and ought to be rejected.

Indeed, the situation is truly amazing. The defenders of the mentioned dogma provide no proof for their position. Worse, their position is more untenable than that of any other defender of monopoly because government is not just like any other monopoly, such as a milk or car monopoly that produces low quality products at high prices. Government is unique among all other agencies in that is produces not only goods but also bads. Indeed, it must produce bads in order to produce anything that might be considered a good.

As defined, government is the ultimate judge in every case of conflict - including conflicts involving itself. Consequently, instead of preventing and resolving conflicts, a monopolist of ultimate decision-making will *provoke* a conflict in order to settle it to its own advantage. That is, if one can only appeal to government for justice, justice will be perverted in favor of government, constitutions and supreme courts notwithstanding. Indeed, these constitutions and courts are *government* constitutions and courts, and whatever limitations on government action they may find is invariably decided by agents of the very same institution. Predictably, the definition of property and protection will be altered continually, and the range of jurisdiction expanded to the government's advantage. The idea of eternal and immutable law which is *discovered* will disappear and be replaced by the idea of law as legislation, as *state-made* law.

Moreover, government is a monopolist of taxation, and while those who receive the taxes - the government employees - regard taxes as something good, those who must pay taxes regard the payment as something bad, as an act of expropriation. As a tax-funded life-and-property protection agency, then, the very institution of government is nothing less than a contradiction in terms. It is an expropriating property protector, "producing" ever more taxes and ever less protection. In fact, even if a government limited its activities exclusively to the protection of the property of its citizen, the further question of *how much* security to produce would arise. Motivated, as everyone is, by self-interest and the disutility of labor but equipped with the unique power to tax, a government agent's goal will invariably be to *maximize expenditures* on protection - and almost all of a nations' wealth can conceivably be consumed by the cost of protection - and at the same time to *minimize the production of protection*. The more money one can spend and the less one must work, the better off one will be!

In sum, the incentive structure established with the institution of government is not a recipe for protection of life and property, but indeed a recipe for maltreatment, oppression, and exploitation.

And this is precisely what the history of states illustrates.

Consider that shining example of a protective state: the US - the wonderland that people everywhere are supposed to emulate.

According to the pronouncements of our state rulers and their intellectual bodyguards, we are better protected and more secure than ever. We are supposedly protected from global warming and cooling, from the extinction of animals and plants, from the abuses of husbands and wives, parents and employers, from poverty, disease, disaster, ignorance, prejudice, racism, sexism, homophobia, and countless other public enemies and dangers.

In fact, however, matters are strikingly different.

In order to provide us with all this "protection", the state managers expropriate more than 40% of the incomes of private producers year in and year out (about $ 15,000 per person) compared to which even the economic burden imposed on slaves and serfs seems moderate. Government debt and liabilities have increased uninterruptedly (unfunded liabilities are currently $ 80 trillion, or six times GNP), thus increasing the need for future expropriations. Owing to the substitution of government paper money for gold, financial insecurity has increased sharply, and we are continually robbed through currency depreciation.

Every detail of private life, property, trade, and contract is regulated by ever higher mountains of paper laws (the index of the Code of Federal Regulations alone contains about 800 pages), which has created permanent legal uncertainty and moral hazard. In particular, we have gradually been stripped of the right to exclusion inherently implied in the very concept of private property. As sellers we cannot sell to and as buyers we cannot buy from whomever we wish. As members of associations we are not permitted to enter into whatever restrictive covenant we believe to be mutually beneficial. As Americans, we must accept immigrants we do not want as our neighbors. As teachers, we cannot get rid of ill-behaved students. As employers, we may not fire incompetent or destructive employees. As landlords, we are forced to put up with undesirable tenants. As bankers and insurers, we are not allowed to avoid bad risks. As restaurant and bar owners, we must accommodate unwelcome customers and cannot appropriately accommodate welcome ones. As members of private associations, we are compelled to accept members and actions in violation of our own rules and restrictions.

Moreover, while the state has made continuous efforts to disarm its population and thus rob it of all means of self-defense, crime rates have gradually increased, notwithstanding ever higher budget allocations. On the other hand, in the name of the so-called war on drugs, the state arrests more than 1 million offenders of victimless crimes per year as criminals, and it often confiscates the defendant's means of defense against such accusations before the trial has even started. Further, the war on drugs has provided the state the opportunity to destroy essentially all of our financial privacy and bank secrecy.

In the name of patriotism and homeland security, the state can now tap our telephones and read our emails.

The FDA causes untold pain and suffering day in and day out by delaying or even prohibiting the timely marketing of pharmaceutical drugs.

The department of HUD manages to infest formerly safe residential districts with crime through its placement of low-cost housing within homogeneous middleclass residential districts.

Through its ill, incompetent, and inefficient maintenance of all of its so-called public goods and utilities, the state contributes to wild fires, floods, and other natural or man-made disasters as the events surrounding hurricane Katrina have recently shown. There was no timely evacuation, despite plenty of warning time and ample means of bus transportation. There was no water supply and no electricity for weeks. The habitation of flood prone areas was subsidized. There was a total breakdown of law and order in the Superdome and outside. Large groups of policemen deserted, and looting, even with the participation of city police, was rampant. Private relief efforts were hampered by FEMA officials.

In short, the more the state has increased its expenditures on social security and public safety, the more our private property rights have been eroded, the more our property has been expropriated, confiscated, destroyed or depreciated, and the more we have been deprived of the very foundation of all protection: economic independence, financial strength, and personal wealth.

The path of every president and practically every member of Congress is littered with hundreds of thousands of nameless victims of personal economic ruin, financial bankruptcy, impoverishment, despair, hardship, and frustration.

But this is far from all. The state is supposed to protect us from foreign enemies and dangers. Indeed, the US now has an annual defense budget that some analysts have estimated at $ 750 billion per year, or $ 3,000 per person.

Yet curiously, the borders of the US have never been seriously threatened. Actually, the borders were threatened only once during the War of Southern Independence from 1861-65, and on that occasion the Union government earned the unique distinction of declaring war against a large part of its own population and engaging in the wanton murder of hundreds of thousands (600,000) of its own citizens.

As for the rest of the military ventures, they were essentially aggressive and imperialist in nature. The US had no business in WWI, yet its participation in this war played a decisive role in bringing communism to Russia, fascism to Italy, national-socialism to Germany, in preparing the fields for WWII, in turning most of central and eastern Europe communist as well, and thus contributing mightily to making the twentieth century the century of socialism and one of the bloodiest centuries in all of human history.

In sum, while we have become more helpless, impoverished, threatened, and insecure, the US government has become ever more brazen and aggressive. In the name of national security, it defends us mostly outside of the US, equipped with enormous stockpiles of weapons of aggression and mass destruction from ever new Hitlers and suspected sympathizers.

Are we safer now from foreign threats? That is highly doubtful. Intervention creates unreliable friends. Indeed, it creates enemies and foes everywhere. The events of 9-11 2001 are revealing: The government is supposed to protect us from terrorism. Yet what was its role in the terrorist attack on the World Trade Center and the Pentagon?

Despite its enormous military budget and a worldwide network of spies and informants, the government was unable to prevent commercial airliners from being hijacked and used as missiles against prominent commercial and military targets. Worse, the government not only failed to prevent the disaster, it actually contributed to the likelihood of the event. In pursuing an interventionist foreign policy (taking the form of economic sanctions, troops stationed in more than 100 countries, relentless bombings, propping up despotic regimes, taking sides in irresolvable land and ethnic disputes, and otherwise attempting political and military management of whole areas of the globe), the US government provided the very motivation for foreign terrorists and made the US their prime target.

How was it possible that men armed with no more than box cutters could inflict the terrible damage they did? Obviously, this was only possible because the government prohibited airlines and pilots from protecting their own property by force of arms, thus rendering every commercial airline vulnerable and unprotected against hijackers. A $ 50 pistol in the cockpit could have done what $ 100s of billions in the hands of government were unable to do. Moreover, the mightiest power on earth could not even prevent an attack on its own military headquarters, the Pentagon, Do we need to know more about the utter failure of government as our protector?!

What can we learn from all this? What can we do to improve our security?

First and very importantly, I have destroyed the myth here that governments are effective protectors of life and property. Nothing could be further from the truth. They are the most dangerous enemies of life and property. Where do we learn this dangerously false myth? In the public schools, which we are forced to attend during our most impressionable years. They are designed to be the centers of statist indoctrination. "Without states, chaos would break out." You have all heard this nonsense.

Thus, a first fundamental step in regaining security lies in regaining intellectual sanity, and this requires the total privatization of the educational system. Get the state out of education. This is not expensive. People, like bureaucrats, who spend other people's money rather than their own tend to be "generous" with this money. Accordingly, public (tax-funded) schools are far more expensive than private schools. In particular, poor people would benefit tremendously through the replacement of public by private education.

Secondly, as already indicated repeatedly, security is most importantly a matter of financial wealth. Great wealth, diversified assets (regarding type and geographical location), the ownership of several homes and several passports, ready access to private means of transportation - these are the things that give us a sense of security. However, they have been largely restricted to the richer strata in society. They should become increasingly available to all strata; but this is only possible if the rapacious appetite of the state for our property is curtailed and resisted, and more and more of our productive output remains where it originates and belongs, namely in our private hands. State expenditures should fall year after year and the proportion of privately produced wealth remaining in private hands increase from year to year.

Third, states have always tried to disarm their subjects, because it is easier to rob an unarmed than an armed man. To regain our security, the right to self-defense, which includes in particular the right to bear arms, must be restored. Only slaves are not permitted to own arms, and it is a sign of a free man, that he does own arms. Furthermore, free armed men must be permitted to form militias. Contrary to government propaganda, the more guns there are, the less crime there is. Indeed, the decentralized militia structure of Switzerland was an important reason for the unwillingness of Nazi Germany to invade Switzerland. Surely the Nazis would ultimately have succeeded in occupying a much smaller country, but the price of trying to do so appeared prohibitive.

Fourth, the European Community has just passed strict anti-discrimination laws - laws that are incompatible with the right to private property, which includes the right to include and exclude others at will, for whatever reason, provided one is willing to pay the price for such discrimination. It is important to criticize, undermine, or at least ignore and not enforce such laws. For private protection and security, it is essential that people be free to form exclusive protective covenants (gated communities). These communities are composed of comparatively homogeneous members, which reduces transaction costs, reduces security expenditures, lowers insurance premiums, and enhances security all-around through greater social control. They allow people to live under a self-chosen law code (including matters of conflict arbitration). Ostracism, which such communities allow, is one of the most powerful means of bringing about civilized behavior.

Last but not least, there must be an economically sound vision regarding what can take the place of the state as judge and policeman. Such a vision exists: Law and order can be provided at comparatively low cost and infinitely higher quality than is the case under statist conditions by private, freely financed insurance firms. (See my books *Democracy the God That Failed* and *The Myth of National Defense* for details.)

While states do not indemnify their subjects if they have failed in the obligation to protect our life and property, insurance companies do. For purely financial reasons, that makes insurance companies efficient in the prevention of crime, in the recovery of stolen loot, as well as in the apprehension of criminals. The disastrous records of tax-funded monopolists in this regard hardly need to be mentioned.

Insurance companies would encourage the private ownership of weapons as means of self-defense with lower premiums, just as they offer lower premiums if clients have an alarm system or a safe at home. There is no need to discuss the state in this connection.

States can externalize the cost of aggression onto hapless taxpayers and thus are by nature aggressive. Insurance companies are by nature defensive organizations. They would not cover the risks associated with provocative or aggressive behavior of their clients but insist on civilized non-provocative conduct as a requirement for insurance.

Insurance companies would not legislate. Instead they would offer fixed contracts which could only be changed with the consent of all parties concerned. Insurance firms would, in the case of interagency conflicts (conflicts between clients of different insurers) resort to independent and competing arbitration agencies which would make an attempt to reach solutions deemed fair by all parties. Otherwise, they would not be chosen for the task again. States do it differently. If citizens have a conflict with a state official, it is another state official (judge) who decides about right and wrong - with a predictable systematic bias.

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ERBM SPEECH

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Financial Institutions, Their Regulation and Impact on Security and Terrorism

A speech by Dr. Richard W. Rahn delivered at the 2nd ERBM, Vilnius, October 15

Should government regulate financial institutions? I expect most people would answer "yes" to that question, but if you ask them "why," I expect these same people will have a hard time giving an answer that makes sense.

Some may say, "in order to prevent financial institutions from engaging in fraud or misrepresentation." But we do not need regulation to do that; in virtually all countries there are already statutes against fraud and misrepresentation, and businesses that behave badly can be dealt with through normal civil and criminal legal means. Others, who are a bit more sophisticated, might argue that we need to regulate business in order to protect people from "market failures." However, the empirical evidence is that there are far fewer "market failures" than commonly imagined, and many of these so-called market failures are actually a result of misguided government policy or regulation.

For a minute, try to imagine a world without government regulation, but where all of the standard laws against theft, fraud, misrepresentation and bodily injury still exist. Under such a scenario, what do you think would happen if we had no food and drug administration to tell us what was safe to consume? No financial regulators to protect us from bank failures and financial scams? No health and safety regulators to protect us from unsafe products? Would we all die? Not likely, because the judicial system, coupled with private standard setting associations, would likely give us an equal, if not a higher, level of protection than we have now.

More than a century ago, when electrical appliances were first being developed and sold, there was a problem in that many of the new products shocked their customers and/or started fires. The electric appliance industry quickly understood that this situation was dangerous and not good for business and thus started an industry sponsored organization to test products to make sure they were safe and reliable. The organization was called Underwriters Laboratories. It still exists today to ensure that electrical products bearing the UL seal are safe, and its mark has become the standard. In the absence of regulation, virtually every industry would do the same thing, because legitimate enterprises know that being branded for selling faulty products would ruin their reputation and put them out of business. Unfortunately, as a result of ceaseless propaganda from pro-government interest groups, most people have been brainwashed into thinking they need regulatory agencies to protect them.

A most provocative paper was recently published by the American Enterprise Institute, written by former U.S. Treasury General Counsel Peter Wallison, entitled "Why Do We Regulate Banks?" Mr. Wallison argues that "it is difficult to identify a sound policy reason for regulating banks. Most of the conventional explanations -- inherent bank instability, deposit insurance, the Federal Reserve's role as lender of last resort, or the Federal Reserve's role in the large-dollar payment system -- turn out on examination to be either unfounded or based on risks that the government need not take in order to foster growth of the economy." Mr. Wallison goes on to detail "the huge costs to the taxpayers and the economy" caused by bank and Saving & Loan Association failures that have been due to regulation. Finally, Mr. Wallison, who has had major regulatory responsibility, concludes as to the question, "Why do we regulate banks?, that we do so because we want to, not because we must."

The arguments Mr. Wallison makes for the U.S. are in most cases equally applicable to other countries. Banking is no more unstable than most other businesses. Bankers can make errors in judgment, and, if so, their bank will suffer, and their competitors will gain an advantage. Bankers can be dishonest, but regulation cannot prevent most cases of willful dishonesty and laws against crime will not prevent the crime if an individual is set upon committing one. In most countries, the existing criminal statutes are sufficient to punish wrongdoers.

In the absence of government regulation, industry associations step in to provide codes of conduct and procedures for best practice. In virtually every legitimate industry, members have a vested interest in keeping out the corrupt and incompetent because it hurts everyone's business. The financial industries are particularly sensitive to industry and product reputation. A bank or other financial institution that causes problems will most likely be expelled from the relevant industry associations, and consumers will be informed by the associations who is and who is not in good standing.

Because consumers believe that government regulators can protect them in many ways that they cannot, consumers tend to be less diligent in looking at the health and reputation of companies that are known to be regulated, which is very true with regulated financial industries.

In some countries, such as the U.S., the government provides "deposit insurance" in case the bank fails. There is no reason that providing "deposit insurance", needs to be a government function. In some countries, such insurance is provided by private insurance companies, as it would be in the U.S. and other countries if they exited from government insurance programs. Private insurance would merely transfer the cost of the insurance from the taxpayer to the depositor, where it belongs.

It is often argued that financial institutions need to be regulated in order to handle a shock to the system – e.g., the failure of a large institution, a failure by a foreign government to fulfill its financial obligations or where the government fails to allow its own financial institutions fulfill their obligations, particularly, when it spills over to institutions in other countries. Government regulation of financial institutions can rarely prevent such financial shocks – and very frequently one or more governments or international financial institutions are the cause. Government bailouts add to systemic risk, whereby participants in the financial system from depositors to bank managers fail to exercise due caution because of the belief that the government will bail them out of their mistakes.

People around the globe are justifiably concerned about terrorism and ordinary criminality. A certain international political class has used this anxiety to argue that since criminals and terrorists use money, all monetary movements and holdings must be monitored. Yes, it is useful to be able to trace the money trail of al Qaeda operatives. But does that mean all citizens of every country should be subject to having all their financial privacy destroyed? Furthermore, is it cost-effective to monitor almost everyone, or would both public and private law enforcement dollars be more wisely spent monitoring the activities of those individuals or groups known or strongly suspected of engaging in terrorist or criminal activities?

Both U.S. and non-U.S. financial institutions are faced with a barrage of new rules and regulations from their own and foreign governments, plus the European Union, and from international institutions, such as the Organization for Economic Cooperation and Development (OECD), the Financial Action Task Force (FATF), the International Monetary Fund (IMF), and the United Nations (U.N.). The agencies within the U.S. government, issuing the new financial rules and regulations, include the Internal Revenue Service, the Federal Bureau of Investigations (FBI), the Justice Department, the Financial Crimes Enforcement Network (FinCen) and the Federal Reserve.

In addition, millions of other businesses which are not strictly financial institutions but are "money service providers" – such as real estate agencies, car dealers, and pawn shops -- are subject to, at least, some of these new rules and regulations, and it is almost impossible to inform them of their obligations. Even the largest international banks, with huge staffs of lawyers and anticrime enforcement personnel, are unable to fully work through this ever-expanding morass of regulation. Smaller banks and businesses are at a competitive disadvantage because of the disproportionate effect of these regulatory costs. Some of the regulators are aiming at terrorists, others at ordinary criminals, and some at tax avoiders or evaders. Most of the regulations are directed at "money launderers," even though the term has a very elastic definition.

Many of these new rules and regulations are overlapping, some are contradictory, some violate basic civil liberties, and many are costly to administer and do not meet reasonable cost-benefit tests. The reason we should care is that all of these extra, and in many cases totally unnecessary, costs are passed along to consumers of financial services as higher fees and more expensive and fewer choices in financial products. This directly translates into job losses, not only in financial industries, but in all businesses that rely on some outside financing.

In addition, these regulations make it more difficult for low-income people, the young and recent immigrants to open bank accounts. Costly regulations that force more people into the cash economy not only make life more dangerous for those who cannot open bank accounts, but also have the perverse effect of making it more difficult for law enforcement to trace funds of criminals. There is little evidence that all the new rules and paperwork are having any appreciable effect on crime or terrorism, because there is an almost infinite number of ways to "launder" money, and organized terrorists and criminals can nearly always find ways around the regulations. On the other hand, there is considerable evidence of damage to our pocketbooks and civil liberties from these regulations.

An international private sector organization should be created to demand and conduct strict cost-benefit and civil liberties' tests to all proposed regulations emanating from international bodies like the OECD, FATF, IMF, and the U.N., as well as those from governments that affect nonresident institutions.

In May, 2002, the *Task Force on Information Exchange and Financial Privacy* issued its **Report of Financial Privacy, Law Enforcement, and Terrorism.** Among the recommendations of the tax force are:

1. Better target anti-money laundering laws by creating watch lists to be provided to financial institutions rather than collecting millions of pieces of paper on law abiding citizens.
2. Prioritize national security, anti-terrorism and serious crime in information exchange efforts.
3. Take more aggressive steps to prevent sensitive information held by governments from reaching hostile hands.
4. Limit financial information sharing to responsible governments where dual criminality exists, where the requests for such information are limited to specific persons or institutions, and where such requests have been approved by the appropriate judicial authorities in each government.

In conclusion, if financial institutions and their customers are weakened or bled to death by regulatory malpractice, the war against real criminals and terrorists will only be made more difficult.

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If you don't create a free market, a black market will emerge

The founders of LFMI are – Prof. Kęstutis Glaveckas, Nijolė Žambaitė, Dainius Pupkevičius, Petras Auštrevičius, Elena Leontjeva and Darius Mockus.

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